SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927.

No. 425.

MIDLAND NATIONAL BANK OF MINNEAPOLIS,
Petitioner,

vs.

DAKOTA LIFE INSURANCE COMPANY,
Respondent.

Petitioner's Brief

STATEMENT.

The petitioner brought this action in a state court against respondent who caused the action to be removed to the United States District Court for Minnesota on the ground of diversity of citizenship (R. 1-7). The pleadings were several times amended. There was a Complaint (R. 1-3), an Amended Answer (R. 8-22), an Amended Complaint (R. 22-34), an Answer to Amended Complaint (R. 34-49). In the Answer to Amended Complaint the respondent pleaded fraud in connection with the procurement of the policy, but on motion the allegations as to fraud in the procurement of the policy were stricken out as irrelevant and redundant matter, because Section 6635c, North Dakota Compiled Laws 1913, required the policy in question to contain "a provision that the policy shall

constitute the entire contract between the parties and shall be incontestable after two years from its date, except for non-payment of premiums and except for violation of the conditions of the policy relating to naval and military services in time of war" (R. 49-54). There had been no contest within the two-year period. Thereafter on motion the respondent obtained leave to substitute an amended pleading, which appears in the record entitled, "Proposed Amended Answer to Amended Complaint" (R. 56-61). In this substituted pleading no question was raised as to the validity of the policy in its inception. To this petitioner filed its Reply (R. 62-64).

Thus, when the parties came to trial, the issues were framed by the Amended Complaint, the so-called "Proposed Amended Answer to Amended Complaint" and the Reply. It should be helpful to understand what these issues were.

The Amended Complaint alleged that on May 14, 1920, in the State of North Dakota, respondent made and delivered to one Oscar Mosher a policy of insurance on the life of said Mosher in the sum of $10,000. The policy was payable to the estate of Mosher (R. 23). So much was admitted by respondent because not denied either generally or specifically.

Petitioner also alleged that on October 10, 1921, Mosher assigned the policy to one J. E. Jacobson (R. 23). This was not denied by respondent's pleading, but respondent alleged that this assignment was to secure a pre-existing indebtedness in the sum of $5,686.08, then owing by Mosher to the Dazey State Bank, of which Jacobson was president (R. 56).

The Amended Complaint alleged further that on February 26, 1923, both Mosher and Jacobson assigned the policy to petitioner (R. 23, 24). This assignment recited that it was "given to secure the payment" to petitioner

of "the sum of Ten Thousand and 00/100 Dollars, according to the tenor and conditions of two promissory note" (R. 33). Respondent admitted the execution of this assignment (R. 58), but alleged that on January 13, 1923, two $5,000 notes were obtained from Mosher and his wife as makers, payable to the order of Jacobson, by means of fraudulent misrepresentations that such notes were in renewal of an indebtedness of the Moshers to the Dazey Bank in the sum of $4,193.84, whereas there was in fact no indebtedness whatever owing to Jacobson, and that the assignment of February 26, 1923, was also obtained from Mosher through the fraudulent misrepresentation that it was given to secure the said indebtedness to the Dazey State Bank rather than the two $5,000 notes (R. 57, 58). In this connection respondent also conceded that the two $5,000 notes were endorsed by Jacobson to petitioner as collateral security to a pre-existing indebtedness of Jacobson to petitioner in a larger amount.

The other allegations in the Amended Complaint setting forth the death of Mosher, the payment or extension of premiums, the giving of notice and proof of death ~~of~~ by petitioner were not controverted.

The respondent pleaded a decree in a State court in North Dakota, in a suit commenced June 19, 1923, to which petitioner concededly was not a party, cancelling the policy as against the administratrix of Mosher (R. 59-60).

Petitioner proved at the trial that the two $5,000 notes endorsed by Jacobson were received by it on March 2, 1923, as collateral security for a larger indebtedness on the part of Jacobson to petitioner; that the policy and two assignments were received at the same time as collateral for the two $5,000 notes (the policy thus being sub-collateral for Jacobson's indebtedness and liability to petitioner); that petitioner became the absolute owner of the two $5,000 notes through foreclosure sale of the

pledged property and that nothing was ever paid on the notes (R. 77-96).

Respondent's offer of an authenticated copy of the findings and judgment in the North Dakota action was refused on the ground that the exhibit was immaterial and irrelevant (R. 109, 175-184).

Respondent also made a lengthy offer to prove by three witnesses, Sophia Mosher, Ladbury and Bell, that there was a lack of consideration and (possibly) fraud practiced upon Mosher in connection with the delivery of the two $5,000 notes in January, 1923. These offers had no reference whatever to what transpired in connection with the issuance of the policy in 1920. The offered testimony was excluded on the ground that it was immaterial and irrelevant matter, and that proof of fraud practiced upon Mosher in procuring an assignment of the policy would not constitute a defense available to the insurance company (R. 114-122).

Both parties having moved for a directed verdict (R. 122-123), the trial judge made a general finding in favor of petitioner for the full amount claimed (R. 66). See opinion, R. 67-70. Judgment was entered accordingly (R. 66, 67).

The cause thereupon came before the Circuit Court of Appeals for the Eighth Circuit upon writ of error. There were six assignments of error as follows:

> I and II, assigning the order of the trial court in striking out portions of the Answer to the Amended Complaint (R. 188).
>
> III, assigning the exclusion from evidence of the North Dakota judgment (R. 189).
>
> IV, V, and VI, assigning the denial of the offers of proof by witnesses Sophia Mosher, Ladbury and Bell (R. 190-192).

In its opinion (by Lewis, J.) the appellate court sustained the trial court as to the matters covered by assignments I, II, and III, *supra* (R. 197-200). But in paragraph numbered 4 of the opinion the court held that "on the proof and the tendered and rejected proof" the policy was a wagering contract and void in its inception in 1920 except to the extent of the then indebtedness of Mosher, the insured, to the Dazey State Bank. The opinion erroneously stated such indebtedness "the answer alleged, amounted to $5,686.08 at the time the policy issued" (R. 198). In fact there was no evidence or allegation showing what, if any, indebtedness there was at that time. The judgment of District Court was accordingly reversed (R. 202). See 18 F. (2d) 903.

The petitioner filed a petition for rehearing which was denied May 26, 1927, without further opinion (R. 202-203).

Certiorari was granted October 31, 1927.

ANALYSIS OF THE JUDGMENT BELOW REVERSING THE JUDGMENT OF THE DISTRICT COURT.

From the opinion of the Circuit Court of Appeals it appears that the proceedings in the District Court were sustained and reversed in the following particulars:

1. Sustained in holding that the North Dakota judgment or decree was not binding upon the petitioner.

2. Sustained in holding that lack of consideration or fraud practiced upon Mosher in connection with the assignment of the policy to the petitioner would not constitute a defense to respondent.

3. Sustained in holding that fraud in connection with the inception of the policy would not constitute a defense because of the incontestable clause required by the North Dakota statute.

4. Reversed for excluding the offered proof on the

theory that such offered proof would have shown the policy to have been in part a wagering contract in its inception. The court held that the incontestable clause required by the statute would not prevent the assertion of such a defense.

SUMMARY OF ARGUMENT.

Respondent has not petitioned for certiorari and if we understand the practice of this Court the correctness of the decision of the Circuit Court of Appeals will not be questioned except in respect to the errors asserted in the petition for certiorari.

Federal Trade Com'n v. Pacific States Paper Trade Ass'n, 47 Sup. Ct. Rep. 255, 259.

Accordingly we do not cite in the ensuing argument the authorities in support of the judgment of the District Court as against Assignments of Error I, II, and III (R. 188-190). We will urge only the errors assigned in the petition for certiorari and supporting brief, viz.:

1. The Circuit Court of Appeals has reversed the District Court on matters of fact and on a point of law that were not before the District Court.

2. Even if the record were as the Circuit Court of Appeals understood it to be, the incontestable clause would bar any controversy as to the validity of the policy in its inception.

3. Even if the record were as the Court below understood it to be, that Court erred in holding the policy a wagering contract as a matter of law.

ARGUMENT.

First Point.

The Circuit Court of Appeals Has Reversed the District Court on Matters of Fact and on a Point of Law that Were Not Before the District Court.

1. It is stated at the beginning of the opinion of the court below:

> "The questions that are reviewable on this writ relate to the exclusion of offered proof in the light of the pleadings * * *" (R. 197).

And at the end of the opinion the court says:

> "So we conclude on the facts stated that the policy was a good and valid contract to the extent of Mosher's indebtedness to the Dazey State Bank on May 14, 1920, and that the court erred in excluding the tendered proof. If the tender should be made good and the case does not present a materially different aspect from the record before us, plaintiff should have judgment for that amount, with interest from service of summons" (R. 201).

From this it sufficiently appears that the reversal was based solely on the exclusion of proof at the trial.

2. As already shown the validity of the policy in its inception in 1920 was not in issue under the pleadings, but on the contrary admitted. As already stated the excluded proof had reference only to matters alleged to have transpired in 1923 in connection with the assignment of the policy to petitioner.

The only possible questions in the case when the parties came to trial were:

> 1. Was fraud practiced upon the assignor of the policy and, if so, would it be a defense to the insurance company?
>
> 2. Was the decree of cancellation of the policy by the North Dakota court a defense to the insurance Company?

3. Was petitioner entitled to a full recovery, having received the two $5,000 notes, and the assignment of the policy as collateral security for a pre-existing indebtedness?

It is certain that no other questions were considered to be in the case by the trial judge. See opinion (R. 67-70).

We quote from the statement in the opinion of the Circuit Court of Appeals:

> "That company (respondent) offered to show that the policy was applied for and issued at the instigation of Jacobson; that he retained possession of it for the Dazey State Bank; that Mosher assigned it to that bank when it was issued and that bank paid the first and all other premiums; * * * that at the time and for some time theretofore Mosher had tubercular consumption in an advanced state and continued in that condition until his death which occurred on September 10, 1923; * * * that Mosher never had or kept the policy under his control, that it was taken out by and solely for the benefit of his creditor, the Dazey State Bank; * * *" (R. 198).

To one who reads the opinion carefully it becomes obvious that the entire texture of the wager argument is built upon the foregoing recitals. *Yet the matters stated were not contained in the rejected offers of proof; they were not even alleged in the pleadings as amended when the parties came to trial; there was no evidence of such matters actually received or offered.* There was nothing, absolutely nothing, in the amended pleadings, the evidence received, or the rejected proof out of which the court could weave a wager contract. A reversal of the judgment of the trial court based upon such a profound misapprehension of the record is, in our experience, quite without precedent. Yet the petition for rehearing wherein these manifest errors were pointed out was denied without further opinion.

If the judgment of the Circuit Court of Appeals is not reversed, the District Court will presumably receive the

excluded testimony. What then? Is the District Court to hold the policy in part a wagering contract although there is still no such issue and no such testimony in the case? The only solution for this difficulty that occurs to us is that the judgment of the Circuit Court of Appeals be reversed.

3. It has been suggested on behalf of respondent that the decision of the Circuit Court of Appeals must be considered as reversing the judgment of the District Court on the ground that the District Court improperly struck out on motion a part of the Answer to Amended Complaint. It is contended that the stricken pleading tendered the defense that the insurance policy was a wagering contract.

There is no ground for such an assertion; the language of the decision of the Circuit Court of Appeals is too clear to permit of doubt that the reversal was based upon what the Circuit Court of Appeals thought was excluded as evidence.

Furthermore the Answer to Amended Complaint did not raise the defense that the insurance policy was a wager. This pleading set forth that at the date of the policy Mosher was indebted to the Dazey State Bank "in a substantial sum of money, the exact amount whereof is unknown to this defendant" (R. 36). It set forth an assignment of the policy to the Dazey State Bank in furtherance of an alleged conspiracy to defraud the insurance company by misrepresenting the state of health of the insured (R. 42). The gist of the defense of the Answer to Amended Complaint was fraud and conspiracy to defraud; it was not contended that the Dazey State Bank was not a creditor of the insured in a sufficient amount to give it an insurable interest. As a matter of fact the District Court did not strike the allegations with respect to the indebtedness of the insured to the Dazey State Bank

or the allegation that the policy was assigned to the Dazey State Bank (R. 49-51). These allegations were abandoned by respondent itself when it sought and obtained leave to substitute the "Proposed Amended Answer to Amended Complaint" "in lieu of said answer to the amended complaint" (R. 55-61). In the substituted pleading neither the indebtedness of the insured to the Dazey State Bank at the inception of the policy or the assignment of the policy to that bank is mentioned.

Respondent elected to go to trial upon entirely different defenses from those found in the pleading which had been partially stricken. Under such circumstances it is established law that any error in striking the abandoned pleading is waived. It would be superfluous to cite cases in support of this elementary proposition. The decisions are collected in 3 *Corpus Juris*, p. 667, Sec. 538. Any other rule would be absurd because upon reversal of the judgment of the trial court and a new trial the issues would still be framed by the substituted pleading, and the new trial could not be expected to reach a different result.

The order striking out parts of the first answer to the Amended Complaint was not subject to review for the further reason that no exception was taken by respondent or preserved by incorporation in the bill of exceptions.

Ghost v. United States, 168 Fed. 841 (C. C. A. 8th Cir.).

Dietz v. Lymer, 61 Fed. 792 (C. C. A. 8th Cir.).

Denver, etc., Ry. Co. v. Wagner, 167 Fed. 75 (C. C. A. 8th Cir.).

In the light of the language of the decision of the Circuit Court of Appeals, as well as the foregoing considerations, the abandoned Answer to Amended Complaint does not call for further consideration.

4. It was error for the Circuit Court of Appeals to reverse the judgment of the District Court on the sole

ground that the District Court had excluded certain proof for the following reasons:

1. The proof excluded was entirely different from what the appellate court stated it to be.
2. The excluded proof had nothing whatever to do with the inception of the policy as assumed by the appellate court, but had reference solely to an assignment of the policy almost three years later.
3. The excluded proof had no bearing on the point of wager upon which the appellate court based its decision.
4. The question of wager was not an issue under the pleadings.
5. The validity of the policy in the first instance was admitted by the pleading.
6. The question of wager was not litigated by consent and there was no evidence in the case having a tendency to show that the policy was a wagering contract.

Second Point.

Even If the Record Were as the Court Below Understood It to Be, the Incontestable Clause Would Bar Any Controversy as to the Validity of the Policy in Its Inception.

1. A few courts have held that an incontestable clause in a life insurance policy, in so far as the defense of wager or lack of insurable interest is concerned, is contrary to public policy and ineffectual *pro tanto* even after the contestable period has expired.

Bromley's Ad'r v. Washington Life Ins. Co., 129 Ky. 402; 92 S. W. 17.

Clement v. N. Y. Life Ins. Co., 101 Tenn. 22; 46 S. W. 561.

The New York court has taken what appears to be the better view that the incontestable clause applies to the defense of lack of insurable interest, in the same way that

it would apply to any other defense not expressly excepted by its terms.

Wright v. Mutual Benefit Life Ass'n, 118 N. Y. 237.

2. In cases of fraud the authorities are agreed that the lapse of a reasonable time specified by an incontestable clause will be a bar to the assertion of the defense.

Mutual Life Insurance Co. v. Hurni Co., 263 U. S. 167.

Great Southern Life Ins. Co. v. Russ, 14 F. (2d) 27.

Plotner v. Northwestern National Life Ins. Co., 48 N. D. 295; 193 N. W. 1000.

In a case like the present where the policy of insurance is issued with the consent of the person whose life is insured, there seems to be no reason why there should be a stronger public policy against the policy becoming enforceable than in cases where the policy was procured through fraud. We think this is shown by the rule adopted by this court that a valid life insurance policy may be assigned by the insured to one who has no insurable interest in his life.

Grigsby v. Russell, 222 U. S. 149.

The House of Lords has called the defense of want of insurable interest "a shabby thing."

Burnand v. Rodocanachi, 7 App. Cas. 333, 340.

This language seems especially appropriate where the defense is asserted (or assumed to be so asserted by the Circuit Court of Appeals) by an insurance company against an assignee whose assignment was formally approved by the company almost three years after the policy was issued (R. 34). Life insurance policies have a rapidly increasing significance in the commercial world as collateral security. The incontestable clause is intended to give such policies, after the prescribed period has elapsed, a value which is comparable to the value given to commercial paper by reason of its negotiable character. For this

reason alone the decision of the Circuit Court of Appeals seems most unfortunate.

3. The few decisions which hold that the incontestable clause does not operate upon the defense of want of insurable interest were all cases where the incontestable clause was a private arrangement between the parties, which was considered to contravene public policy. Such decisions certainly have no application where the incontestable clause is required by the governing statute. Public policy is to be determined by the appropriate legislature, in this case the North Dakota legislature. *When that legislature has said that the policy shall be incontestable after two years, it is indefensible for any court to hold that it knows better about public policy, or to read exceptions into the clause which are not there.*

In *Whitfield v. Aetna Life Ins. Co.*, 205 U. S. 489, this court said:

> "An insurance company is not bound to make a contract which is attended by the results indicated by statute in question. If it does business at all in the State, it must do so subject to such valid regulations as the State may choose to adopt. Even if the statute in question could be fairly regarded by the court as inconsistent with public policy or sound morality it cannot for that reason alone be disregarded; for it is the province of the State by its legislature to adopt such a policy as it deems best, provided it does not, in so doing, come into conflict with the Constitution of the State or the Constitution of the United States."

4. In *Northwestern Life Ins. Co. v. Johnson*, 254 U. S. 96, this court held that an incontestable clause reading—"This contract shall be incontestable after one year from the date of its issue, provided the required premiums are duly paid" could only be construed as barring the defense of suicide after the period indicated. Mr. Justice Holmes said in the opinion:

> "The public policy with regard to such contracts is a matter for the States to decide. * * * The object of the clause is plain and laudable—to create an absolute assurance of the benefit, as free as may be from any dispute of fact except the fact of death, and as soon as it reasonably can be done. It is said that the insurance companies now generally issue policies with such a clause. The State decisions, so far as we know, have upheld it. Unless it appears that the State concerned adopts a different attitude we should uphold it here."

On principle the Johnson case cannot be distinguished from the case at bar.

Third Point.

Even If the Record Were as the Court Below Understood It to Be, That Court Erred in Holding the Policy a Wagering Contract as a Matter of Law.

1. Even if the Circuit Court of Appeals had been correct and the reception of the offered proof would have established that the policy had been taken out for the protection of the Dazey State Bank as a creditor of the life insured, in the sum of $5,686.08 according to the court's understanding, it was error to hold that the policy was invalid as to the excess over the then indebtedness as a matter of law.

The rule is that where a creditor insures or causes to be insured the life of his debtor he is entitled to recover the full amount of the insurance unless there is such a gross discrepancy between the amount of the debt and the amount of the insurance that the transaction shows on its face that it is a mere wager. The dictum in *Connecticut Mutual Life Ins. Company v. Schaefer*, 94 U. S. 457, 462, that "the amount of insurable interest is the amount of the debt" does not accurately state the law on this subject.

Insurance Company v. Bailey, 13 Wall. 616, 619.

Insurance Company v. Mowry, 96 U. S. 544, 545.
Connecticut Mut. Life Ins. Co. v. Lucks, 108 U. S. 498.
Sides v. Knickerbocker Life Ins. Co., 16 Fed. 650.
Curtiss v. Aetna Life Ins. Co., 90 Calif. 245.
Amick v. Butler, 111 Indiana 578.
Rittler v. Smith, 70 Maryland 261; 16 Atl. 890.
Ulrich v. Reinoehl, 143 Pennsylvania 238.
Wheeland v. Atwood, 192 Pennsylvania 237.
37 *Corpus Juris* 396.

Now a $10,000 policy to secure an indebtedness of $5,686.08, when the interest to accrue on the indebtedness and the cost of maintaining the insurance is taken into consideration (in this case the annual premium was $394.20; R. 26) is not such a gross discrepancy as to show bad faith. On the contrary such a substantial indebtedness, in the light of the decisions on the subject, would appear to take the question of insurable interest out of the case.

In the decision of the Circuit Court of Appeals it is said:

> "The insurable interest of the Dazey State Bank was limited to an account reasonably adequate to cover Mosher's indebtedness to it and premiums which it would have to pay and interest" (R. 200).

But in what follows and in the conclusion of the opinion there is language from which respondent will contend, in case of a new trial, that petitioner's recovery is limited to the exact indebtedness at the time the policy was issued. The effect of this would be to make it impossible for the creditor to secure himself against future interest and future premiums. It is settled that if there is an insurable interest at the date of the policy, the cessation of that interest thereafter does not affect the right of recovery.

Conn. Mutual Life Ins. Co. v. Schaefer, 94 U. S. 457.

Therefore the question of insurable interest must be determined as of the date of the policy. The creditor must

be allowed such a margin as will cover interest to accrue and premiums to be paid. This margin cannot be calculated according to any mathematical rule. Unless the discrepancy is so great as to show bad faith, the courts should not interfere. Certainly they should not look to subsequent events, such as payments of interest and premiums, as the Circuit Court of Appeals does in its decision, to determine whether the policy was disproportionate in amount when made.

The decision of the court below also seems in conflict with the North Dakota statutes dealing with this subject:

> "Every person has an insurable interest in the life and health * * * of any person under a legal obligation to him for the payment of money, or respecting property or services, of which death or illness might delay or prevent the performance * * *." Comp. L. 1913, Sec. 6628.
>
> "Unless the interest of a person insured is susceptible of exact pecuniary measurement, the measure of indemnity under a policy of insurance upon life or health is the sum fixed in the policy." *Id.*, Sec. 6631.

If there was any question of insurable interest under the court's view of the record, that question would be determined by the good faith or bad faith of the creditor, the Dazey State Bank. That question was for the jury.

Cooley, Briefs on Insurance, Vol. I, page 328.

The judgment of the Circuit Court of Appeals should be reversed and the judgment of the District Court should be affirmed.

Respectfully submitted,

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